

REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA

A REVIEW OF THE SAN JUAN SUBURBAN WATER DISTRICT'S
ACCOUNTING CONTROLS, CONTRACTING PRACTICES,
AND EXPENDITURE OF BOND PROCEEDS

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OFFICE OF THE AUDITOR GENERAL

F-762

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AND EXPENDITURE OF BOND PROCEEDS

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Telephone:
(916) 445-0255

STATE OF CALIFORNIA
Office of the Auditor General

660 J STREET, SUITE 300
SACRAMENTO, CA 95814

Thomas W. Hayes
Auditor General

July 20, 1988

F-762

Honorable Bruce Bronzan, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 448
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning a review of the San Juan Suburban Water District's (district) accounting controls, contracting practices, and expenditure of bond proceeds. The district is currently in sound financial condition, and with a few exceptions, has sound control over its financial operations. Also, the district generally complied with state contracting laws and complied with the state law in issuing its 1979 bonds and in spending the bond proceeds. However, we noted several areas in which the district could improve its operations. For example, the percentages that the district uses to allocate its overhead expenses to its wholesale and retail divisions are not supported and are outdated.

Respectfully submitted,



for THOMAS W. HAYES
Auditor General

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SUMMARY

RESULTS IN BRIEF

The San Juan Suburban Water District (district) is currently in sound financial condition and, with a few exceptions, has sound controls over its financial operations. Also, the district generally complied with state contracting laws and followed similar contracting practices to those used by other community services districts that operate as water districts. Furthermore, the district has complied with state law in issuing bonds in 1979 and in spending the proceeds from the bonds. However, during our review, we noted several areas in which the district could improve its operations.

Specifically, the percentages that the district uses to allocate its overhead expenses to its wholesale and retail divisions are not supported and are outdated. However, overhead expenses represented only 19 percent of the district's total expenses for fiscal year 1986-87.

Further, the district could improve its accounting controls in the following areas:

- The district pays the members of its board of directors their monthly expenses even though board members fail to sign their reimbursement requests and fail to always provide receipts;
- The district lacks documentation to prove that the board requested its members to attend activities other than board meetings and that the board approved payment for attendance at these activities. Further, the district paid and loaned public funds for spouses of the board members and district employees to attend some of these activities;
- The district does not always promptly re-evaluate fee advances from developers at the completion of construction projects;

- The district does not have a review system to verify that water connection fees have been correctly charged and calculated; and
- The district does not have sufficient controls over its \$2,000 emergency checking account.

Finally, based on our review and a legal opinion from the Legislative Counsel, for two contracts, totaling approximately \$1 million, the district did not comply with the state law that requires it to obtain competitive bids for contracts involving construction work. These contracts were for the one-time construction of the district's modular filter backwash system.

BACKGROUND

The district was organized in 1954 as a community services district. The district provides water on a wholesale and retail basis to an area of approximately 29,000 acres in Sacramento and Placer counties. The district had operating expenses of approximately \$3.5 million for fiscal year 1986-87 and is estimating operating expenses of approximately \$3.1 million for fiscal year 1987-88. Five directors, elected by the citizens for four-year terms, are responsible for the management of the district.

PRINCIPAL FINDINGS

The Percentages Used To Allocate
Overhead Expenses to the District's
Wholesale and Retail Divisions Are
Not Supported and Are Outdated

The district's overhead expenses accounted for approximately 19 percent of its total expenses for fiscal year 1986-87. Overhead expenses include telephone bills, salaries of administrative personnel, insurance, and other expenses that the district cannot readily identify to either its wholesale or retail

divisions. The district identifies the overhead expenses to specific accounts and allocates these expenses between the two divisions based upon percentages associated with each of these accounts. District officials originally developed these percentages in 1971 based on what they believed was a fair distribution of each account's expenses between the two divisions. However, the district could not provide us with the documentation necessary for us to determine whether these percentages were reasonable. As a result, the district is not able to assure its customers that it correctly allocated its overhead expenses between its wholesale and retail divisions. Further, even though the district has changed significantly since the percentages were developed, the district has not been re-evaluating these percentages regularly to determine whether the percentages should be changed. Consequently, the district could be charging its wholesale and retail divisions more or less than their share of the district's total expenses. Moreover, if the district is not accurately allocating its overhead expenses between the two divisions because the percentages are outdated, the district may not be charging either its wholesale or its retail customers fairly. However, the district is currently in the process of documenting its calculation of the percentages and determining whether these percentages need to be updated.

The District Is Currently in Sound
Financial Condition but Could Improve
Its Accounting Controls in Some Areas

The district's last five annual reports, which were audited by independent certified public accountants, indicate that the district is currently in sound financial condition. However, the district could improve controls over its accounting records in some areas. Specifically, the district paid the members of its board of directors approximately \$34,400 in expenses from July 1986 through February 1988 even though board members failed to sign their reimbursement requests and did not always provide receipts. In addition, the district

lacks documentation to prove that the board requested its members to attend activities other than board meetings and that the board approved payment for attendance at these activities. Further, the district paid and loaned at least \$3,600 in public funds for spouses of the board members and district employees to attend some of these activities. Also, the district does not promptly re-evaluate developers' fees at the completion of a project. The district receives payments in advance from developers for the estimated cost of linking new developments to the district's existing water pipelines. However, the district did not promptly re-evaluate 8 of 16 advances at the completion of the related construction projects. For 6 of the 8 advances, the district owed developers approximately \$7,200, and the developers owed the district approximately \$5,900. Furthermore, the district does not have a review system to verify that water connection fees have been correctly charged and calculated. As a result, for some of the applications for water connection services that we reviewed, we found that the property owners and developers paid approximately \$15,100 when they should have paid the district approximately \$24,500 according to the fee schedule in effect at the time of the fee payment. Finally, the district does not have sufficient controls over its \$2,000 emergency checking account.

The District Generally Complied With
State Contracting Laws and Followed
Similar Contracting Practices of
Other Community Services Districts

We reviewed the district's contracting procedures for 13 contracts totaling approximately \$3.9 million and found that the district generally complied with the State's contracting laws and regulations applicable to community services districts. However, based on our review and a legal opinion from the Legislative Counsel, we found two contracts, totaling approximately \$1 million, for which the district did not comply with the state law that requires the district to obtain

competitive bids for contracts involving construction work over \$10,000. These two contracts were for the one-time construction of the district's modular filter backwash system. In addition, between January 1978 and November 1987, 16 of the 59 contracts that the district awarded were for the services of an engineering firm. The district awarded these 16 contracts using contracting practices similar to those used by other water districts for awarding contracts for engineering services. Further, the district calculates its engineering fees as a percentage of the final cost of a construction project. This percentage is comparable to the percentages other community services districts operating as water districts use to pay their engineers.

The District Has Complied With
State Law in Issuing Bonds in
1979 and in Spending the Proceeds

The district complied with state laws when it issued bonds in 1979. For example, the district's board of directors determined whether the whole or only a portion of the district would benefit from the completion of construction projects (bond projects) to be financed with monies from the sale of the 1979 bonds. In addition, the district has a system to ensure that bond proceeds, which are monies from the sale of the 1979 bonds, are spent only for approved bond projects. Further, the district has complied with the approved purposes of the bonds when spending the proceeds. Finally, the district has reported all bond project expenses to the State Treasurer's Office.

RECOMMENDATIONS

To improve its system for allocating its overhead expenses, the San Juan Suburban Water District should take the following actions:

- Develop support for the percentages that it uses to allocate the expenses, re-evaluate the percentages periodically, and adjust

them, if necessary, to ensure that they reflect the current conditions of the district; and

- Determine what effect any changes in these percentages would have on the total expenses of either the wholesale or retail division and adjust customer rates accordingly.

To improve its accounting controls, the district should take the following actions:

- Ensure board members sign their reimbursement requests and submit all necessary supporting receipts;
- Document both the board's requests for its members to attend activities other than board meetings and also its approval of payments for attendance at these activities;
- Prohibit the payment of public funds for items for anyone other than board members, district officers, and district employees;
- Prohibit the loan of public funds;
- At the completion of a construction project, promptly re-evaluate the developer's fees;
- Establish a review system to verify that water connection fees have been correctly charged and calculated; and
- Ensure sufficient controls over its \$2,000 emergency checking account.

Finally, to ensure that it complies with the state contracting requirements for community services districts, the district should obtain competitive bids for all contracts involving the construction of a unit of work exceeding \$10,000.

AGENCY COMMENTS

The San Juan Suburban Water District and the board are currently implementing the recommendations contained within our report.

INTRODUCTION

The San Juan Suburban Water District (district) was organized in 1954 as a community services district under the Community Services District Law, Government Code, Section 61000 et seq. Although the district could provide a wide range of services, it has only provided water services since its inception. Five directors, elected by the citizens for four-year terms, are responsible for the management of the district.

The district provides water on a wholesale and retail basis to an area of approximately 29,000 acres in Sacramento and Placer counties. The wholesale operation of the district consists of operating water treatment, storage, pumping, and distribution facilities and delivering the water to six purchasers for resale. Five of the purchasers are the Citrus Heights Irrigation District, the Fair Oaks Irrigation District, the Orangevale Mutual Water Company, the City of Folsom, and the Placer County Water Agency. The district's sixth wholesale customer is the district's retail division, which serves approximately 5,200 retail customers directly.

The district had operating expenses of approximately \$3.5 million for fiscal year 1986-87 and is estimating operating expenses of approximately \$3.1 million for fiscal year 1987-88. The district distributes its operating expenses between its retail and wholesale operations.

In 1972, the district began a comprehensive program to expand and to improve its entire water system. From calendar year 1974 through calendar year 1976, the district sold \$6,100,000 in general obligation bonds and promissory notes for this expansion. Again in 1979, after receiving voter approval, the district sold \$8,750,000 in general obligation bonds to complete the original program. The district is using the proceeds of the latest bond issue to complete improvements to the water treatment, storage, and distribution facilities. The Department of Health Services required the majority of these improvements. The Sacramento and Placer counties collect property taxes for the district based on the assessed values of all property within the district. In turn, the district uses the property taxes to pay the bond principal and interest.

SCOPE AND METHODOLOGY

The primary purpose of this audit was to review and evaluate the district's accounting system including the adequacy of the cost-allocation system and the adequacy of the district's internal controls. In addition, we evaluated the district's contracting activities and procedures. Finally, we reviewed the district's 1979 bond issue to determine whether the bond proceeds and interest were used in accordance with the provisions authorized by the voters.

To determine the adequacy of the district's cost-allocation system, we interviewed key accounting personnel. To determine whether the system was operating as the district's staff had described it to us, we selected some expenses to follow through the system to the district's financial statements. We also reviewed the system to determine whether the district's methods for allocating expenses between the wholesale and retail divisions seemed reasonable. We did not review the allocation of costs for the district's wholesale customers because the district hired consultants who recently completed an extensive study of the district's wholesale rates.

To determine the adequacy of the district's internal accounting controls, we interviewed key accounting personnel to gain an understanding of the district's cash processing, accounts payable, and expense and revenue systems. In addition, we assessed the strengths and weaknesses of the district's internal accounting controls and tested a sample of accounting transactions to determine whether the system was operating properly.

To evaluate the district's contracting activities and procedures, we reviewed the district's compliance with state and local contracting laws. In addition, to determine whether the district complied with contract provisions, we reviewed 13 contracts totaling approximately \$3.9 million and the supporting documents for engineering services and construction work. To determine whether the district's board of directors awarded contracts to the lowest bidder that complied

with the bid requirements (the lowest responsible bidder), approved contract changes, and accepted the completed project, we reviewed board minutes, board resolutions, and competitive bidding documents. Finally, to determine common contracting procedures as they relate to engineering contracts for community services districts that operate as water districts, we interviewed staff from the Office of the State Architect, the Department of Water Resources, community services districts, local engineering firms, and the Districts Securities Division of the State Treasurer's Office (STO).

To determine how the proceeds of the district's 1979 bonds should have been used, we reviewed the resolutions of the district's board of directors, Measure D that authorized issuance of the bonds by the district's voters in June 1978, the official bond statement, and the orders of the Districts Securities Division of the STO. To determine the adequacy of the controls that prevent misappropriation of bond proceeds, we reviewed the procedures that the district and the STO used to approve and issue bonds and monitor the spending of the proceeds. To determine whether the district's 1979 bond proceeds were properly spent and reported to the STO, we selected a sample of 48 percent of the expenses from bond proceeds and three reports of expenses to the STO and tested these expenses to determine whether they were accurate and in compliance with the bonds' approved uses.

In addition, we reviewed information regarding the district that was of interest to the Legislature. The Appendix provides this information, including discussions of the district's wholesale contracts, water rights, water-meter installations, the engineering firm with which the district contracts, and the district's urban water management plan.

AUDIT RESULTS

I

THE PERCENTAGES USED TO ALLOCATE OVERHEAD EXPENSES TO THE SAN JUAN SUBURBAN WATER DISTRICT'S WHOLESALE AND RETAIL DIVISIONS ARE NOT SUPPORTED AND ARE OUTDATED

The overhead expenses of the San Juan Suburban Water District (district) accounted for approximately 19 percent of the district's total expenses for fiscal year 1986-87. Overhead expenses consist of telephone bills, salaries of administrative personnel, insurance, and other expenses that the district cannot readily identify to either its wholesale or retail divisions. The district identifies the overhead expenses to specific accounts and allocates these expenses between the two divisions based upon percentages associated with each of these accounts. District officials originally developed these percentages in 1971 based on what they believed was a fair distribution of each account's expenses between the two divisions. However, the district could not provide us with the documentation necessary for us to determine whether these percentages were reasonable. As a result, the district is not able to assure its customers that it correctly allocated its overhead expenses between its wholesale and retail divisions. Further, even though the district has changed significantly since the percentages were developed, the district has not been re-evaluating these percentages regularly to determine whether the percentages should be changed. Consequently, the district could be charging its wholesale and retail divisions more or less than their

share of the district's total expenses. Moreover, if the district is not accurately allocating its overhead expenses between the two divisions because the percentages are outdated, the district may not be charging either its wholesale or its retail customers fairly. However, the district is currently in the process of documenting its calculation of the percentages and determining whether these percentages need to be updated.

Description of How the District Distributes Expenses Between Divisions

The district accounts for its expenses through two divisions: the wholesale division and the retail division. The district earns monies to maintain its wholesale division by selling treated water to five wholesale customers who, in turn, are responsible for disbursing the water to their customers. In addition, the district sells its treated water to its own retail division, which operates as the district's sixth wholesale customer. The district's retail division is responsible for disbursing the water to approximately 5,200 consumers. The district earns monies to maintain its retail division by charging its retail consumers a monthly fee.

The district is able to directly associate approximately 81 percent of its total expenses as a cost of either its wholesale or retail divisions and applies these direct expenses to the two divisions accordingly. Examples of direct expenses include the cost of

purchasing water, the costs for materials for repairing pipelines, and the labor costs associated with specific district projects. We performed limited tests of the district's direct expenses and nothing came to our attention that would lead us to believe that the district incorrectly applied the direct expenses. The district also has overhead expenses that constituted approximately 19 percent of the district's total expenses for fiscal year 1986-87. Overhead expenses consist of telephone bills, salaries of administrative personnel, insurance, and other expenses that the district cannot readily identify to either its wholesale or retail divisions. The district identifies the overhead expenses to specific accounts and allocates these expenses between the two divisions based on percentages associated with each of these accounts. District officials originally developed these percentages in 1971 based on what they believed was a fair distribution of each account's expenses between the two divisions.

The Percentages Used To Allocate
Overhead Expenses to the District's
Wholesale and Retail Divisions Are
Not Supported and Are Outdated

To determine whether the district was allocating its overhead expenses between its wholesale and retail divisions according to district policy, we selected some overhead expenses to follow through the district's cost-allocation system to the district's financial statements. We found that the district identified overhead expenses to

the appropriate overhead accounts and allocated overhead expenses to the wholesale or retail divisions using the percentages that it established for each account. However, the percentages used to allocate the overhead expenses to the divisions are not supported and are outdated.

According to the district's general manager, the district developed the percentages during 1971, and they became effective January 1, 1972, when the district first started to separately account for its wholesale and retail operations. The district's general manager also stated that, at that time, the district's certified public accountants, the general manager, and the engineer developed the percentages to reflect what they believed was a fair distribution of each overhead account's expenses between the two divisions, based upon their knowledge of the district's operations. The district continues to use the original percentages although the district's controller changed a few percentages when he recognized a major change in how costs should be applied.

Preferred cost-accounting practices require that costs be allocated between divisions based upon some logical methodology. For example, the district could allocate its overhead salary expenses to each division based on the percentage of direct salary expenses charged to each division. If the district charged 30 percent of its direct salary expenses to its wholesale division and 70 percent to its retail division, then the district could allocate its overhead salary expenses

to its two divisions using the same percentages. It is the responsibility of the district's management to decide which methods they will employ in the development of the percentages that they use to allocate expenses between the district's wholesale and retail divisions. At the time of our audit, the district had not developed the documentation necessary for us to determine whether the district employed a logical method when it developed these percentages. Because the district cannot provide documentation to support these percentages, it cannot assure its customers that it is correctly allocating its overhead expenses between its wholesale and retail divisions.

Further, since the percentages were developed in 1971, the district has changed significantly. For example, the district currently serves approximately 5,200 retail customers, compared with approximately 2,500 retail customers in 1971. Because the district's retail customer population has more than doubled since 1971, more of the district's administrative time may be spent performing retail-related services rather than wholesale-related services. On the other hand, the district has added one wholesale customer to its five original customers, which may have increased the district's administrative time spent performing wholesale services. Even though these changes have occurred, the district continues to use most of the same percentages developed in 1971 to allocate its overhead expenses.

According to the district's controller, the district has not been re-evaluating the percentages regularly to determine whether the

percentages required changes. Consequently, the district allocated approximately 19 percent of its expenses in fiscal year 1986-87 based on outdated percentages, and the district could be charging its wholesale and retail divisions more or less than their share of the district's total expenses. When the district's board of directors forecasts a significant change in expenses, it normally adjusts its wholesale or retail customer rates accordingly. For example, the district raised its wholesale customer rates by approximately 10 percent in fiscal year 1985-86 in anticipation of a significant increase in expenses. Therefore, if the district is not allocating its overhead expenses between the district's wholesale or retail divisions accurately because the percentages are outdated, the district may not be charging either its wholesale or its retail customers fairly.

However, even if the district's percentages were inaccurate, it is unlikely that the effect on customer rates would be significant. For example, in fiscal year 1986-87, the district reported wholesale expenses totaling approximately \$2 million and retail expenses totaling approximately \$1.5 million. Of the district's total expenses of approximately \$3.5 million, the district identified approximately \$700,000 as overhead expenses. Under current allocation percentages, each division was charged approximately \$350,000 of these overhead expenses. Hypothetically, if the percentages were inaccurate by 10 percent and the retail division received an additional 10 percent in overhead expenses, the retail division's total expenses would have

increased by approximately \$35,000 or 2.3 percent. If the district were to pass on this cost to its 5,200 retail customers, each customer would pay an additional approximately \$.56 per month.

CONCLUSION

The overhead expenses of the San Juan Suburban Water District accounted for approximately 19 percent of its total expenses for fiscal year 1986-87. The district identifies the overhead expenses to specific accounts and allocates these expenses between its wholesale and retail divisions based upon percentages associated with each division's expense accounts. District officials originally developed these percentages in 1971 based on what they believed was a fair distribution of each account's expenses between the two divisions. However, the district could not provide us with the documentation necessary for us to determine whether these percentages were reasonable. As a result, the district is not able to assure its customers that it correctly allocated its overhead expenses between its wholesale and retail divisions. Further, even though the district has changed significantly since the percentages were developed, the district has not been re-evaluating these percentages regularly to determine whether the percentages should be changed. Consequently, the district could be charging its wholesale and retail divisions more or less than their share of the district's total expenses.

Moreover, if the district is not accurately allocating its overhead expenses between the two divisions because the percentages are outdated, the district may not be charging either its wholesale or its retail customers fairly. However, the district is currently in the process of documenting its calculation of the percentages and determining whether these percentages need to be updated.

RECOMMENDATIONS

To improve the San Juan Suburban Water District's system for allocating its expenses, the district should take the following actions:

- Develop support for the percentages that it uses to allocate its overhead expenses, re-evaluate these percentages periodically, and adjust them, if necessary, to ensure that they reflect the current conditions of the district; and
- Determine what effect any changes in these percentages would have on the total expenses of either the wholesale or retail division and adjust customer rates accordingly.

II

THE SAN JUAN SUBURBAN WATER DISTRICT IS CURRENTLY IN SOUND FINANCIAL CONDITION BUT COULD IMPROVE ITS ACCOUNTING CONTROLS IN SOME AREAS

The San Juan Suburban Water District's (district) last five annual reports, which were audited by independent certified public accountants, indicate that the district is currently in sound financial condition. However, the district could improve controls over its accounting records in some areas. Specifically, the district paid some of the members of its board of directors approximately \$34,400 in expenses from July 1986 through February 1988 even though board members failed to sign their reimbursement requests and did not always provide receipts. In addition, the district lacks documentation to prove that the board requested its members to attend activities other than board meetings and that the board approved payment for attendance at these activities. Further, the district paid and loaned at least \$3,600 in public funds for spouses of the board members and district employees to attend some of these activities. Also, the district does not promptly re-evaluate developers' fees at the completion of a project. The district receives payments in advance from developers for the estimated cost of linking new developments to the district's existing water pipelines. However, the district did not promptly re-evaluate 8 of 16 advances at the completion of the related construction projects. For 6 of the 8 advances, the district owed developers approximately \$7,200,

and for the remainder of the 8, the developers owed the district approximately \$5,900. Furthermore, the district does not have a review system to verify that water connection fees have been correctly charged and calculated. As a result, for the applications for water services that we reviewed, we found that property owners and developers paid approximately \$15,100 when they should have paid the district approximately \$24,500 according to the fee schedule in effect at the time of the fee payment. Finally, the district does not have sufficient controls over its \$2,000 emergency checking account.

The District Is Currently
in Sound Financial Condition

The district's annual report for the year ended June 30, 1987, showed that the district had approximately \$5.7 million in cash as of June 30, 1987. In addition, the district had current debt, which is debt the district will have to pay within one year, of approximately \$1 million. Therefore, the district had approximately 5.7 times more cash than current debt as of June 30, 1987. This is one indication that the district is in a sound short-term financial position.

Further, the district's last five annual reports, which were audited by independent certified public accountants, showed that the district's total income was greater than its total expenses in four of the last five fiscal years. For one of the five years, the year ended June 30, 1987, the district reported a net loss of \$26,393. However, this loss resulted from an error by the County of Sacramento in

collecting the tax assessments for the district's bonds. If the error had not occurred, the district would have collected approximately \$800,000 more and would not have reported a loss for June 30, 1987. The County of Sacramento will collect additional taxes from the district's taxpayers during fiscal year 1987-88 to compensate for this error.

The district's bond rating also indicates that the district is currently in sound financial condition. The district has received an "A1" rating on its general obligation bonds from Moody's Investors Service every year that the rating has been published since 1980. This rating indicates that the district's ability to pay its general obligation debt payments as they become due is presently adequate. In addition, the district does not need to rely on water sales to pay its general obligation bond payments because these payments are made from property tax income.

The District Could Improve Its Accounting Controls in Some Areas

During our review of the district's accounting controls over cash, expenses, and revenues, we found that the district could improve its accounting controls in six areas. However, these weaknesses are relatively minor because their potential effect on the accounting records as a whole is insignificant. For example, the district lacks controls over its emergency checking account. However, this account has a maximum balance of \$2,000 while the district's total cash balance

as of June 30, 1987, was \$5.7 million. Thus, if the district suffered a loss of the full balance of its emergency checking account, the loss would have an insignificant effect on the district's overall cash balance.

The Members of the District's Board
of Directors Did Not Always Sign
Expense Reports or Provide Receipts

The California Government Code, Section 61207, allows the district's board to authorize each board member to receive not more than \$100 for each meeting of the board that the member attends or for each day's service that the member renders by request of the board, not exceeding six days in any calendar month. Further, this section states that the board members may be compensated for any expenses incurred in the performance of duties required or authorized by the board.

To receive compensation for meetings and the related expenses, the district's board approved the use of a reimbursement request form on January 14, 1987, that requires directors to provide details of the meetings they attend and to itemize the related expenses. In addition, this form contains a certification as to the accuracy of the expenses included on the form and a corresponding signature block. Before the board's approval of this new form, the district used a less detailed expense form that simply contained a signature block. Sound internal accounting controls require a claimant to sign his own monthly reimbursement request to verify the accuracy and business-related

nature of the expenses. The signature makes the claimant more responsible for the authenticity of the report, especially, if the claimant must make an attestation to that effect. Furthermore, sound internal controls require that claimants include receipts, or if claimants do not have receipts, they should at least attach explanations of all other expenses claimed that are in addition to the amounts per meeting that they are entitled to receive.

Of the 99 payments that we reviewed, the district made 60 payments amounting to approximately \$34,400 even though the corresponding reimbursement requests were not signed by the claimants. Thirty of the 60 payments, totaling approximately \$17,900, were made between July and December 1986, before the board's approval of the new reimbursement request form. During that period, none of the board members signed their reimbursement requests. After the approval of the new reimbursement request form on January 14, 1987, the district continued to pay three board members who did not sign their reimbursement requests even though the new form required the board members to sign a certification as to the accuracy of the expenses included. In fact, the district made 30 payments totaling approximately \$16,600 between January 1987 and February 1988 without obtaining the board members' signatures. In addition, the district made 14 payments that included \$437 of travel and other expenses that were not supported by a receipt or at least an explanation of each expense. Because the district failed to use proper controls, the

district does not have reasonable assurance that all expense payments were for official district business.

The district's secretary frequently prepares the reimbursement requests from information in the district's records of meetings and any other information supplied by board members over the telephone. Further, the district does not require the board members to sign the completed forms.

The District Lacks Documentation To Prove
That the Board Requested Its Members
To Attend Activities Other Than Board
Meetings and That the Board Approved
Payment for Attendance at These Activities

The California Government Code, Section 61207, allows the district's board to authorize each board member to receive not more than \$100 for each meeting of the board that the member attends or for each day's service that the member renders by request of the board, not exceeding six days in any calendar month. Sound internal accounting controls would require the board to approve in advance the types of meetings for which the district compensates its board members and that the district document this approval.

We reviewed the district's monthly list of meetings and activities for which the board members were paid from July 1986 through February 1988. The district recorded as reimbursed activities the board members' attendance at functions such as the employees' Christmas

luncheons, Christmas dinners and meetings of the Sacramento Area Water Works Association, and the Association of Sacramento County Water Districts, meetings of the Central Valley Project Water Association, and conferences of the American Water Works Association. However, the district lacked documentation to prove that the board requested the board members to attend these activities and that the board approved payment for attendance at these activities. The district's board minutes revealed that, although the board passed a resolution to follow the Government Code, Section 61207, and reminded the board members of the dates of some of the activities, the board did not indicate that it had requested and approved each director to attend these activities and to receive compensation for them. As a result, the district cannot be assured that the board members attended these activities at the request of the board and that board members should be receiving payment for attendance at these activities.

The District Paid and Loaned Public
Funds To Pay for the Spouses of Board
Members To Attend Some Activities

The Constitution of the State of California, Article 16, Section 6, prevents the Legislature from authorizing a gift of public monies and from extending credit to individuals. The district was established in accordance with laws enacted by the Legislature and, consequently, also cannot authorize gifts of or loan public monies.

Our review of the district's credit-card receipts for July 1986 through March 1988 revealed that the district paid for spouses of the board members and district employees to attend some activities. These activities were the ones for which the district lacked documentation to prove that the board had requested and approved the members to attend them. In August 1986, the district paid for four airline tickets totaling \$733 for spouses who accompanied four board members to the American Water Works Association conference held in Denver. In addition, in May 1988, the district paid \$1,030 for the airfare of four spouses who plan to attend the American Water Works Association conference with the board members in June 1988. In total, the district paid \$2,811 for airline tickets for the spouses of board members and employees for the period from July 1986 through March 1988.

In addition, although the district was eventually reimbursed, the district initially paid a total of \$754 in May 1987 for the airfare of a board member, spouse, and daughter. The payment included the spouse's airfare of \$258 to accompany the board member to a conference and, at the completion of the conference, the additional cost of \$198 for the board member and spouse to travel to another city unrelated to district business. The district also paid the airfare of \$298 for the board member's daughter to join the board member and his spouse. Four days after the district paid the airfare, the board member reimbursed the district for the additional cost to travel to another city and the daughter's airfare. When the district processed the board member's monthly expense claims for June and August 1987, the remaining portion

of the spouse's airfare of \$258 was deducted from the amount the district owed the board member. The district, thus, lent money to the board member for the purchase of these tickets.

Resolution Number 86-34, which the board approved on May 14, 1986, indicates that a board member may be accompanied by "his wife" on any out-of-town district-related activity and that the expenses incurred for transportation, lodging, or meals are to be covered by the district. However, the Constitution of the State of California, Article 16, Section 6, prevents the Legislature from authorizing a gift of public money or from extending credit to individuals. The district was established in accordance with laws enacted by the Legislature and, consequently, also cannot authorize gifts of or loan public monies. Accordingly, the district may have illegally paid and loaned public monies.

The District Does Not Always
Promptly Re-evaluate Fee
Advances From Developers at the
Completion of Construction Projects

Our review of cash receipts revealed that the district receives payments in advance from developers for the estimated cost of linking new developments to the district's existing water pipelines. When the district completes a project, the district compares the actual cost of the project with the developer's advance payment. If the district's cost is more than the amount the developer advanced, the district requires the developer to pay the difference. On the other

hand, if the district's actual costs are less than the developer's advance payment, the district refunds the difference to the developer. However, the district does not always promptly re-evaluate these advance payments at the completion of a project.

We reviewed 16 completed projects for which the district had received advances from developers and that were included in the accounting records at November 30, 1987. As of March 1, 1988, the district's accounting staff had not re-evaluated 7 of the 16 advances even though the related projects had been completed for 8 to 15 months. According to the district's accounting records, for 5 of the 7 projects, the district owes the developers approximately \$6,500, and for the remaining 2 projects, the developers owe the district approximately \$5,900. In addition, one of the 16 projects was completed for 8 months before the district re-evaluated the related advance. Once the district's accounting staff reviewed the advance, they returned to the developer approximately \$700. Sound accounting controls require that the district promptly review these advances after the completion of the project. If the district does not promptly review these advances and a developer still owes money to the district, the district loses the use of these funds in addition to the interest that could be earned on them between the time the developer completes the project and the time that the developer pays the difference to the district.

The district's controller stated that 3 of the 8 projects were actually incomplete and that accounting staff had erroneously closed the projects. Furthermore, the controller explained that he has delayed reviewing the status of these advances because he has been focusing his attention, for the last two years, on other accounting projects of a higher priority. He is currently attempting to update these accounts.

The District Does Not Have a Review
System To Verify That Water Connection Fees
Have Been Correctly Charged and Calculated

District Ordinance 1B requires that owners or developers apply to the district and pay all applicable water connection fees before the district begins water service to any parcel of land within the district. The fees vary depending on the location of the parcel of land within the district, the size of the parcel of land, the fee schedule in effect at the date of the application, and whether or not a developer had previously completed an underground pipeline system and paid the applicable connection fees for that parcel of land.

When an application for water service is received, one district employee is responsible for determining which fees apply and makes the calculations necessary to arrive at a total connection fee. Sound internal controls would require that a second employee, at an appropriate level of responsibility, review the application to verify that all the fees and the proper fee rates were charged and that the

fees were accurately calculated. However, the district does not have such a review process, and, as a result, four of the eight applications that we reviewed contained mathematical errors, fee omissions, and fee rates that were not in conformance with the fee schedule in effect at the time of the application. For example, transmission and pumping fees were incorrectly omitted from the calculation of total connection fees for one application that we reviewed. Consequently, the district undercharged the applicant \$3,700. On another application, an error in determining and calculating the applicable pumping fee resulted in an overcharge to the applicant of \$104.50.

Because it does not review each application for water service to determine whether all the correct fees were charged, the correct fee rates were used, and the fees were accurately calculated, the district lost a net total of approximately \$9,400 in water connection fees from errors on four of the eight applications that we reviewed.

The District Does Not Have
Sufficient Controls Over Its
Emergency Checking Account

During our review of the district's internal accounting controls, we found weaknesses in the district's controls over its emergency checking account. First, the district does not require supporting documents for all checks written from the emergency checking account. Second, the district's accountant is responsible for reconciling the emergency checking account and is also authorized to

sign checks written on this account. Sound internal controls require that the district retain support for each check prepared from the emergency checking account and that the person responsible for reconciling the account is not also authorized to sign checks from that account. Without supporting documents and proper separation of duties, the district's officials lack assurance that the account is being used only for authorized district purposes.

Until we pointed out these weaknesses, the district's general manager believed that controls over this account were sufficient because the district writes approximately only ten checks per month, the account has a maximum balance of \$2,000, and the person who reconciles the account reviews it for unusual usage. Further, the general manager explained that the district's independent certified public accountants audit the account annually.

CONCLUSION

The San Juan Suburban Water District's last five annual reports, which were audited by independent certified public accountants, indicate that the district is currently in sound financial condition. However, the district could improve controls over its accounting records in some areas. Specifically, the district paid the members of its board of directors approximately \$34,400 in expenses from July 1986 through February 1988 even though board members failed to sign

their reimbursement requests and did not always provide receipts. In addition, the district lacks documentation to prove that the board requested its members to attend activities other than board meetings and that the board approved payment for attendance at these activities. Further, the district paid and loaned at least \$3,600 in public funds for spouses of the board members and district employees to attend some of these activities. Also, the district does not promptly re-evaluate developers' fees at the completion of a project. The district receives payments in advance from developers for the estimated cost of linking new developments to the district's existing water pipelines. However, the district did not promptly re-evaluate 8 of 16 advances at the completion of the related construction projects. For 6 of the 8 advances, the district owed developers \$7,200, and for the remainder of the 8, the developers owed the district \$5,900. Furthermore, the district does not have a review system to verify that water connection fees have been correctly charged and calculated. As a result, for the applications for water services that we reviewed, we found that property owners and developers paid approximately \$15,100 when they should have paid the district approximately \$24,500, according to the fee schedule in effect at the time of the fee payment. Finally, the district does not have sufficient controls over its \$2,000 emergency checking account.

RECOMMENDATIONS

To improve its accounting controls, the San Juan Suburban Water District should take the following actions:

- Pay the board members for their monthly expenses only when the members have signed their reimbursement requests and have submitted all the necessary supporting receipts for expenses;
- Document both the board's requests for its members to attend activities other than board meetings and also its approvals of payments for attendance at these activities;
- Prohibit the payment of public funds for items for anyone other than board members, district officers, and district employees;
- Prohibit the loan of public funds;
- Promptly re-evaluate developers' fees at the completion of the related construction projects;
- Establish a review system to verify that water connection fees have been correctly charged and calculated; and

- Require supporting documents for checks written from the district's \$2,000 emergency checking account, and ensure that the person who reconciles the account does not sign checks drawn on the account.

III

THE SAN JUAN SUBURBAN WATER DISTRICT GENERALLY COMPLIED WITH STATE CONTRACTING LAWS AND FOLLOWED SIMILAR CONTRACTING PRACTICES OF OTHER COMMUNITY SERVICES DISTRICTS

We reviewed the San Juan Suburban Water District's (district) contracting procedures for 13 contracts totaling approximately \$3.9 million and found that the district generally complied with the State's contracting laws and regulations applicable to community services districts. However, based on our review and a legal opinion from the Legislative Counsel, we found two contracts, totaling approximately \$1 million, for which the district did not comply with the state law that requires the district to obtain competitive bids for contracts involving construction work over \$10,000. These two contracts were for the one-time construction of the district's modular filter backwash system. In addition, the district followed contracting practices similar to the practices of other community services districts operating as water districts. Between January 1978 and November 1987, 16 of the 59 contracts that the district awarded were for the services of an engineering firm. The district awarded these 16 contracts using contracting practices similar to those used by other water districts for awarding contracts for engineering services. Further, the district calculates its engineering fees as a percentage of the final cost of a construction project. This percentage is comparable to the percentages other community services districts operating as water districts use to pay their engineers.

The District's Contracting Procedures

The district awards contracts for construction work and for professional services. The construction contracts are awarded for the construction of a unit of work such as a building, a pipeline, or a pump station. The professional service contracts are mainly awarded for engineering services.

The California Government Code, Section 61616, and the Public Contract Code, Section 20682, allow community services districts to award contracts for construction work.¹ Further, the Public Contract Code, Section 20685, requires the district to award contracts after competitive bidding to the lowest responsible bidder for the construction of a unit of work estimated to cost in excess of \$10,000 (\$5,000 before January 1, 1986).² These code sections also state that the district's board of directors may reject all bids or may declare the work to be emergency work and, therefore, have the work performed by force account.³ Finally, the Government Code, Section 61619, states that a district may employ labor and professional

¹In 1983, the Public Contract Code, Section 20682, was formerly the Government Code, Section 61620.

²In 1983, the Public Contract Code, Section 20685, was formerly the Government Code, Section 61626.5.

³When work is performed by force account, the district can purchase necessary materials without obtaining competitive bids.

services, but this section does not state that a community services districts must obtain competitive bids for engineering contracts for professional services.

The District Generally Complied With Applicable State Contracting Laws

We reviewed the district's contracting procedures for 6 of 16 engineering contracts to determine whether the district was in compliance with the State's contracting laws. These 16 contracts were awarded from May 1978 through September 1987. The 6 engineering contracts totaled approximately \$1.5 million. In addition, we reviewed 7 of 43 construction contracts. The 43 construction contracts were awarded from January 1978 through November 1987. The 7 construction contracts totaled approximately \$2.4 million. Further, during our review of these engineering and construction contracts, we reviewed 14 contract change orders totaling approximately \$265,000.

Specifically, we reviewed each contract to ensure that the board of directors approved the contract before the goods or services were received from the contractor or engineer; that the board obtained bids for the contract unless the contract was exempt from competitive bidding; that an engineer evaluated the bids for the district; that the board awarded the contract to the lowest responsible bidder (unless the board had a valid reason for not awarding the contract to the lowest bidder); and that the contract contained all the basic contract

elements such as the identification of the involved parties, the work to be performed, the contract amount, the time by which the work should be completed, and the signatures of the involved parties. If applicable, we reviewed the contract's invoices to ensure that the district withheld 10 percent of the contract amount until the work was completed and the district had re-evaluated the contract. Furthermore, we reviewed the contractor's compliance with contract provisions to ensure that the total amount paid for projects did not exceed the original contract amount and any later amendments. Also, we reviewed whether the board approved invoices before payment, approved contract changes, and accepted the completed contract.

The district generally complied with the state contracting laws and regulations applicable to community services districts for the seven construction contracts and the six engineering contracts that we reviewed. However, we found an immaterial clerical error, totaling approximately \$2,500, on one of the progress billing invoices completed by an engineer. (See page 45 for a description of how this error was resolved.)

In addition, in one instance, the district did not obtain competitive bids for an engineering contract that involved the construction of a unit of work. Because one of the six engineering contracts that we had originally reviewed contained provisions for the construction of a unit of work, we reviewed the remaining ten engineering contracts or contract amendments that the district had

awarded since May 17, 1978, to determine whether any of these ten contained provisions for the construction of units of work. Nine of the ten remaining engineering contracts represented engineering services only and did not contain any provisions for the construction of units of work. Thus, the district was not required to obtain competitive bids for these nine engineering contracts. However, the remaining contract was for the design, construction, and installation of a unit of work that is required to be competitively bid.

For the first contract involving the construction of a unit of work, the district contracted with an engineer on May 17, 1978, to do research and development and to design and build a small modular filter backwash system with a capacity to process approximately one million gallons per day. This contract amounted to \$150,000. The second contract involving the construction of a unit of work and dated April 9, 1980, required the same engineer, using the design developed as a result of the first contract, to construct a much larger modular filter backwash system. The second contract stated that the engineer had developed a new modular filter backwash system that had the potential to perform as well as or better than the conventional systems and that, as a result, the district desired the engineer to design, construct, and install a modular filter backwash system that had the capacity to process 100 or 120 million gallons per day for a contract amount of \$900,000. According to the district's general manager, the district did not obtain competitive bids for these two contracts

because the engineer invented this system, and the engineer is the patent owner of the modular filter backwash system.

To determine whether the district was exempt from obtaining competitive bids for the construction of unique products or products for which a patent has been issued, we requested a legal opinion from the Legislative Counsel. The Legislative Counsel found no exception in the State's contracting laws for unique or patented products. The Legislative Counsel stated that the modular filter backwash system contracts more closely approximate contracts for the construction of a unit of work and, thus, fall under the Public Contract Code, Section 20685, which requires the district to obtain competitive bids for contracts involving the construction of a unit of work.⁴

The District's Contracting Practices
for Engineering Services Are Similar
to the Practices of Other Community Services
Districts Operating as Water Districts

Since 1971, the district has awarded its engineering contracts to one engineer. According to the district's general manager, it employs the same engineer year after year because the engineer is familiar with the operations of the district, is readily available to

⁴In 1983, the Public Contract Code, Section 20685, was formerly the California Government Code, Section 61626.5.

perform consulting and engineering services, and is able to answer specific questions related to the district. Services for which the district may contract with the engineer include designing, planning, managing, and inspecting a project that will be constructed by a building contractor. The fees that the district pays for engineering services are generally based on a percentage of the final construction cost.

We interviewed an engineer from the Office of the State Architect, an employee from the Department of Water Resources, administrative staff from three water districts, engineers from local engineering firms, and a civil engineer from the Districts Securities Division of the State Treasurer's Office to determine whether the district followed contracting practices for engineering services that are similar to the practices of other water districts.

The engineers from the local engineering firms and the administrative staff from the water districts explained that it is common contracting practice for a water district to contract with the same engineer year after year because the engineer becomes familiar with the district and is readily available to answer specific questions related to the district. Furthermore, they also stated that it is standard practice for an engineer to prepare the job specifications, to open the bidding process, to make recommendations to the district's board, to maintain job records including progress billing invoices, and to perform site inspections. In addition, the individuals whom we

interviewed stated that it is common for an engineer who designs the project to act as a construction management consultant during the construction of the project and that it is common for a water district to pay an engineer a negotiated contract amount or a percentage of the final negotiated construction cost. Based on the information obtained through these interviews, we conclude that the district's practices for engineering services are similar to the practices of other water districts.

Finally, the engineers whom we interviewed stated that standard rates do not exist for engineering services; the rates may vary depending on the detail of the work and the level of expertise required to complete the project. However, staff at the Districts Securities Division of the State Treasurer's Office and the Office of the State Architect indicated that engineering fees usually range between 11 to 15 percent of the final construction costs for bond projects but that it is not unusual to see fees as low as 5 percent or as high as 25 percent. The staff of the Districts Securities Division provided us with the expense reports of three other water districts. The engineering fees for these districts ranged from 13.4 to 21 percent of the construction costs. For the engineering contracts that we reviewed, the district paid its engineer between 13.6 to 16.6 percent of the final construction costs. Thus, the percentages that the district uses to pay its engineer are comparable to the percentages that other water districts use to pay their engineers.

CONCLUSION

We reviewed the San Juan Suburban Water District's (district) contracting procedures for 13 contracts totaling approximately \$3.9 million and found that the district generally complied with the State's contracting laws and regulations applicable to community services districts. However, based on our review and a legal opinion from the Legislative Counsel, we found two contracts, totaling approximately \$1 million, for which the district did not comply with the state law that requires the district to obtain competitive bids for contracts involving construction work over \$10,000. These two contracts were for the one-time construction of the district's modular filter backwash system. In addition, the district followed contracting practices similar to the practices of other community services districts operating as water districts. Between January 1978 and November 1987, 16 of the 59 contracts that the district awarded were for the services of an engineering firm. The district awarded these 16 contracts using contracting practices similar to those used by other water districts for awarding contracts for engineering services. Further, the district calculates its engineering fees as a percentage of the final cost of a construction project. This percentage is comparable to the percentages other community services districts operating as water districts use to pay their engineers.

RECOMMENDATION

To ensure that it complies with the state contracting requirements for community services districts, the San Juan Suburban Water District should obtain competitive bids for all contracts involving the construction of a unit of work exceeding \$10,000.

IV

THE SAN JUAN SUBURBAN WATER DISTRICT HAS COMPLIED WITH STATE LAW IN ISSUING BONDS IN 1979 AND IN SPENDING THE PROCEEDS

The San Juan Suburban Water District (district) complied with state laws when it issued bonds in 1979. For example, the district's board of directors determined whether the whole or only a portion of the district would benefit from the completion of construction projects (bond projects) to be financed with monies from the sale of the 1979 bonds. In addition, the district has a system to ensure that bond proceeds, which are monies from the sale of the 1979 bonds, are spent only for approved bond projects. Further, the district has complied with the approved purposes of the bonds when spending the proceeds. Finally, the district has reported all bond project expenses to the State Treasurer's Office (STO).

Bond Projects

The district has been authorized by its voters, its board of directors, and the Districts Securities Division of the STO to spend the \$8.75 million proceeds from the sale of bonds in 1979 to construct a new water-filtration plant; to enlarge, line, and cover the main storage reservoir; and construct any "other works, property, or structures useful or necessary" for the treatment and delivery of

domestic water within the district. The district was required to improve its filtration plant and reservoir to meet the State's health standards for domestic water service. In addition, the district's board of directors, with the approval of the STO, has determined that the construction of the following projects is "useful or necessary:" a pilot water-filter plant, a pipeline from Folsom Reservoir to the new filter plant, and telemetry and controls (an electrical system for measuring water and transmitting the result by radio). The district also determined that the engineering costs related to all of the above projects and the administrative costs of issuing the bonds were also necessary.

The California Water Code, Sections 20082 and 20082.5, allow the district to revise the list of bond projects with the approval of the STO. From April 1979, the date the bonds were sold, to November 1987, the bond proceeds have earned over \$4.2 million in interest income. The district has used these additional monies to add more projects to the original list of approved bond projects. The district obtained approvals for these revisions to the original list of bond projects. These revisions added to the list a new shop, warehouse, and three storage tanks along with the related pipelines. The district also revised the engineering costs on the list to include the additional engineering services necessary to complete the above projects. These approved revisions have expanded the original estimated costs for the bond projects, including contingencies, from \$8.75 to \$12.55 million.

The District Complied With State
Laws When It Issued Bonds in 1979

The California Government Code, Section 61650, requires the board of directors of a community services district to determine the necessity for bond indebtedness, the purpose for which a bond debt is to be incurred, and the amount of the proposed debt and also to establish a time and place for a hearing by the board to determine whether the whole or a portion of the district will be benefited by the bond projects. The board approved Resolution Number 78-131 on March 8, 1978, to fulfill this requirement of the law. The board of directors declared through this resolution that the bonds were necessary and fixed a time and place for a hearing. In addition, the Government Code, Section 61655, requires a board of a community services district to determine whether bond projects will benefit the whole or a part of the district. When it approved Resolution Number 78-138 on March 15, 1978, the district's board determined that the whole district would benefit from the bond projects.

The District Has a System To
Ensure Bond Proceeds Are Spent
Only on Approved Bond Projects

The district has a system to ensure that bond proceeds are spent only on approved bond projects. The California Water Code, Sections 20080 through 20081, requires the district to obtain the approval of the STO before the bonds can be sold and any of the bond

proceeds can be spent on bond projects. The STO evaluates each request for approval to determine whether the bond projects are economically sound and feasible and, if appropriate, grants final approval on all applications. The STO also monitors the district's bond projects through on-site inspections and through reviews of expense reports prepared by the district, as required by the Water Code, Sections 20083 and 20084.

The district's board also reviews and approves all contracts and expenses related to the bond projects. At the completion of all of the bond projects, an independent certified public accountant will audit all bond project expenses and report the total actual expenses of the bond projects financed from the proceeds of the 1979 bonds. We believe these procedures, along with the monitoring efforts of the STO, are sufficient to prevent significant misappropriations of bond proceeds.

The District Is Spending
the Bond Proceeds Only
on Approved Bond Projects

We selected a sample of 30 payments out of the approximately 280 payments made for the bond projects through December 1987. These 30 payments represent about 48 percent of the \$11.6 million spent for the bond projects as of December 1987. The payments were for only approved bond projects, properly supported by invoices or progress billings, mathematically accurate, properly recorded in the district's

accounting records, and properly included in the bond project expense reports to the ST0. However, in testing one of these payments, we found one minor error: the district overpaid a contractor approximately \$2,500 on an \$805,000 bond construction project because of a clerical error on one of the progress billing forms completed by the consulting engineer in 1984. We also discovered this same error during our test of contracts. We brought this error to the attention of the district's general manager, and the district has collected this overpayment from the contractor.

The District Has Reported All
Bond Project Expenses to the ST0

We reviewed 3 of the 34 expense reports that the district had submitted to the ST0 as of November 1987 and found that the district had properly reported all bond project expenses. In addition, we verified the mathematical accuracy of all 34 expense reports and found two minor clerical errors. Although these errors resulted in a net overstatement of \$2,622, they only represent .02 percent of the \$11.6 million in bond project expenses reported as of November 1987. The district will correct these errors on the next report to the ST0.

In addition, we reconciled the total bond project expenses reported to the ST0 with the total payments from the district's bond checking account to verify that the total in bond project expenses reported to the ST0 agrees with the district's expense records. We

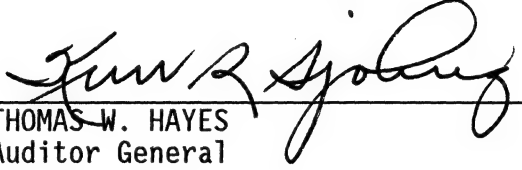
found that the \$11.6 million spent from the bond checking account materially agreed with the \$11.6 million in bond project expenses reported to the STO from May 1979 through November 1987.

CONCLUSION

The San Juan Suburban Water District complied with state laws when it issued bonds in 1979. For example, the district's board of directors determined whether the whole or only a portion of the district would benefit from the completion of construction projects to be financed with monies from the sale of the 1979 bonds. In addition, the district has a system to ensure that bond proceeds, which are monies from the sale of the 1979 bonds, are spent only for approved bond projects. Further, the district has complied with the approved purposes of the bonds when spending the proceeds. Finally, the district has reported all bond project expenses to the State Treasurer's Office.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,


for THOMAS W. HAYES
Auditor General

Date: July 18, 1988

Staff: Sally Filliman, CPA, Audit Manager
Denise L. Vose, CPA
Joseph Maestretti, CPA
Mary Bensorosky
Mark Wallace

ADDITIONAL INFORMATION OF INTEREST TO THE LEGISLATURE

We have included below additional information regarding the San Juan Suburban Water District (district) that was of interest to the Legislature.

Loss of the District's Rights to
Approximately 28,000 Acre-Feet of Water

We were asked to determine what the circumstances were that led to the district's loss of approximately 28,000 acre-feet of water that it had been previously entitled to receive from Folsom Reservoir.

The district had rights to the waters flowing in the north fork of the American River as the result of a 1853 filing with Placer County. However, in 1954, the district accepted a contract (number DA-04-167-eng-610) with the federal government that allowed the federal government to remove or alter any of the district's existing facilities on the American River to construct the Folsom Reservoir. In exchange, the district received the rights to a maximum of 33,000 acre-feet of water annually from the Folsom Reservoir.

In 1962, the district entered into a second contract (number 14-06-200-152-A) with the federal government. This contract provided the district with the possibility of receiving an additional 40,000 acre-feet of water by the year 1992, in addition to the 33,000 acre-feet of water the district was already entitled to receive. However, to eventually receive the full 40,000 acre-feet of water, the contract required that the district utilize and pay for a projected quantity of water every five years. The first five years covered the period from March 1, 1962, to February 28, 1967, and the contract required that the district use 3,500 acre-feet of water annually. However, at the close of the first five-year period, the district had only paid for and used an average of 983.6 acre-feet of water annually. As a result, using a calculation provided in the contract, the federal government reduced the maximum amount of 40,000 acre-feet of water annually that the district could have received to a maximum of 11,200 acre-feet of water annually. In effect, the district lost the possibility of receiving an additional 28,800 acre-feet of water annually (the 40,000 acre-feet of water minus the 11,200 acre-feet of water) because of its underutilization of water during the 1962 to 1967 period.

Wholesale Water Contracts

We were asked to review the terms of the district's wholesale water contracts and determine whether the contracts have expiration dates and any provisions for low-water or drought years.

The district has formed contracts to supply water to the following five wholesale purchasers: Orangevale Mutual Water Company, Citrus Heights Irrigation District, Fair Oaks Irrigation District, the City of Folsom, and Placer County Water Agency (PCWA).

The wholesale water contracts require the wholesale water purchasers to buy the water from the district at the current wholesale water rates established by the district's board of directors. The wholesale water rates include the costs of acquiring the raw water, the treatment of the water, the storage of the water, and the transmission and pumping of the water to the wholesale purchaser's delivery point. The wholesale rates vary for each wholesale purchaser because the location of the delivery points and transmission lines are different for each purchaser. For example, the wholesale water rates are higher for the City of Folsom and the PCWA than for the other wholesale purchasers because the district must pump the water uphill to transmit the water to the delivery points for these two wholesale purchasers.

Four of the five wholesale contracts require the district to provide the wholesale purchasers with a total of at least 32,575 acre-feet of water annually. In turn, these four contracts require the four wholesale purchasers to pay for at least 32,575 acre-feet of water annually whether the water is used or not. To supply these wholesale purchasers with the minimum water requirements, the district is entitled to receive a total of 33,000 acre-feet of water annually, without charge, from the federal government. In addition, based on a 1962 contract with the federal government and a 1967 revision, the district is entitled to receive an additional 11,200 acre-feet of water annually from the federal government. The fifth wholesale purchaser, the PCWA, through a 1982 contract, provides the district with the PCWA's own water, and the district treats the water and returns the water to the PCWA.

Although the wholesale contracts do not contain provisions for low-water or drought years, the district's general manager stated that the wholesale purchasers would receive the minimum contract amounts in a drought year and any additional water supply would be systematically distributed among those wholesale purchasers requiring more water. Moreover, to limit the unnecessary use of water, the district would implement water conservation measures.

Lastly, four of the five contracts continue for indefinite periods or until cancelled by mutual agreement of the contracting parties. The 1982 contract between the district and the PCWA remains in effect through December 31, 1991.

Agreements With Placer County Water Agency

We were asked to determine whether the terms of the agreements between the district and the PCWA were followed.

In 1972, the district approved a contract with the PCWA in which the PCWA agreed to provide 5,000 acre-feet of water per year to the district with incremental increases over the years to a maximum of 25,000 acre-feet in 1992. This contract is in effect until the year 2021. This contract and its amendments limit the use of such water to only the district's retail customers residing in Placer County.

In addition, on January 19, 1982, the district approved a second contract with the PCWA in which the PCWA agreed to purchase water from the district for use by PCWA customers residing outside of the district's boundaries. The PCWA did not have the capability to provide water to one of its small service areas located in south Placer County when the service area's wells went dry. On the other hand, the district could easily provide the needed water because the PCWA service area was located near the district's water transmission lines. Thus, the PCWA contracted with the district to treat and deliver water to this small service area. The district supplies this service area with approximately only 350 acre-feet of water per year and uses the PCWA water provided to the district in the 1972 contract.

According to the general manager of the PCWA, the PCWA verifies that the district is complying with the contracts by reviewing the meter and use records supplied by the district to the PCWA. The PCWA has determined that, thus far, the district has complied with the terms of the contracts.

Installation of Water Meters

We were requested to provide some background information regarding the approval of Ordinance Number 86-176 on May 28, 1986, by the district's board of directors. The ordinance mandated the installation of water meters for the district's retail customers.

According to Resolution Number 86-130 of the board, the decision to install meters was made as the result of a nine-month study performed by a professional utility rate consultant. The board's purpose in installing meters is to promote water conservation, to eliminate a projected fiscal shortfall, to develop customer equity regarding the rates charged, and to ensure a sufficient supply of water for the future.

However, on December 23, 1986, the board of directors approved Resolution Number 86-130, which declared a one-year moratorium on the installation of water meters because some customers within the district suggested that additional time be given for further consideration of the necessity of metering. On December 23, 1987, the board of directors extended the moratorium on the installation of meters for an

indefinite period of time to allow sufficient time to review additional information regarding this issue. In addition, the district halted the shipments of water meters until the metering issue was resolved.

Engineering Firm

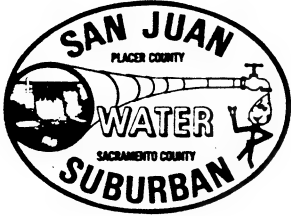
We were requested to determine how much the district has paid its engineering firm, Clendenen Engineers Incorporated, and to determine the sources of these funds.

The district contracts with Clendenen Engineers Incorporated for bond and district projects requiring engineering services. Since the issuance of the 1979 bonds, the district has paid a total of approximately \$4,014,000 to the engineering firm for engineering and related services. The district paid approximately \$2,780,000 of this total from the proceeds of the 1979 bond issue and paid approximately \$1,234,000 from the district's general fund.

Urban Water Management Plan

We were requested to determine whether the district adopted an urban water management plan as required by the California Water Code, Section 10620, and whether the district is following the plan.

On September 21, 1983, the Legislature approved Chapter 1009, which added Section 10620 to the Water Code. Section 10620 requires that "every urban water supplier serving water directly to customers shall, not later than December 31, 1985, prepare and adopt an urban water management plan." In response to this legislation, the district prepared its urban water management plan, which its board of directors adopted on December 23, 1985. The plan includes discussions of conservation measures that the district had already enacted, alternative conservation measures such as the installation of meters, and an evaluation of wastewater reclamation. According to the district's general manager, the district is following the guidelines of the plan that pertain to the conservation and use of water.



San Juan Suburban Water District

P.O. BOX 2157 • ROSEVILLE, CALIFORNIA 95746 • (916) 969-2279
9935 AUBURN FOLSOM ROAD, ROSEVILLE, CALIF. 95661 • (916) 791-0115

Jack B. Hansen
General Manager and Secretary

DIRECTORS

Mark E. Verke, *President*
Robert R. Sullivan, *Vice President*
Glenn A. Miller
Albert C. Ricksecker
Clois W. Snyder, Jr.

July 13, 1988

Mr. Thomas W. Hayes, Auditor General
State of California
Office of the Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Hayes,

Please find enclosed the District's response to the audit report conducted by your office. The response is to be included in the report when issued, as you indicated in your letter dated July 6, 1988.

Please acknowledge receiving the response by executing the appropriate place on this letter.

Thank you.

Sincerely,

Jack B. Hansen
JACK B. HANSEN
General Manager & Secretary

JBH:d11

Signature_____

Date_____

Time_____

COMMENTS AND RESPONSE

BY

SAN JUAN SUBURBAN WATER DISTRICT

TO:

"REPORT BY OFFICE OF THE AUDITOR GENERAL

F-762

A REVIEW OF THE SAN JUAN SUBURBAN WATER DISTRICT'S

ACCOUNTING CONTROLS, CONTRACTING PRACTICES

AND

EXPENDITURE OF BOND PROCEEDS

JULY, 1988"

INTRODUCTION

San Juan Suburban Water District wishes to recognize the quality and thoroughness of the professional efforts expended by the State review team in preparing the report "A Review of the San Juan Suburban Water District's Accounting Controls, Contracting Practices, and Expenditures of Bond Proceeds", dated July 1988.

The actual review activity extended over a period of five months. It involved extensive on-site inspection of District documentation and records, personal interviews with District personnel, and discussions with persons in other public water agencies as well as State officials involved with water. In every instance, the District cooperated fully with the State reviewers, facilitating and supporting their efforts throughout the review period.

In light of the breadth and depth of this review, the District is pleased that the principal findings of the review show, in summary, that:

- The District is in sound financial condition.
- With few exceptions, the District exercises sound controls over its financial operations.
- The District has complied with State law in issuing bonds in 1979 and in spending the proceeds from the bonds.
- The report recommends updating and supporting the District's allocations of overhead expenses between its wholesale and retail divisions. The report also notes that these overhead expenses represents only 19% of the District's total expenses (FY 1986-87), and if changed, would probably have only a minor impact on customer charges.
- The report recommends that the District make improvements in certain accounting controls; these are listed in the report, and several are commented on in this response.
- The report cites a legal opinion that the District should have competitively bid two of its numerous construction projects; it recommends that it do so in future construction situations. This matter is also commented upon in this response.

Thus, based upon an unusually thorough and detailed review, the picture which emerges is, in our view, of a healthy and well-managed District. The discrepancies and procedural matters which were noted are recognized and appreciated.

With regard to the recommended procedural matters, the District has already taken actions on several of them, and is anticipating taking action on all the others. A 6-month study is underway to verify the division of overhead expenses between the wholesale and retail divisions. The administrative changes called for can be readily implemented. A water management consultant has been retained by the District to assist it in evaluating and implementing the recommended changes.

Not mentioned in the report, it should be noted, are the many innovative actions by the District over the years which have resulted in operating efficiencies and savings to San Juan's consumers of millions of dollars. One example alluded to in the report is the design and construction of its computerized, modular filtered backwash system. This unique system has not only proven to be a unique and practical approach, but continues to save District customers substantial sums of money every day. A similar example is the cost-saving power contract negotiated by the District, and there are many other examples.

DETAILED COMMENTS AND RESPONSES

In order to clarify some of the comments contained in the State report, we will address them specifically on the following pages. For ease of reading, the answers are listed in the same order as the topics appeared in the paper.

1.) "Specifically, the percentage that the district uses to allocate it's overhead expenses to it's wholesale and retail divisions are not supported and are outdated."

The procedure which the District uses in allocating indirect costs for overhead has been in place since 1971.

These figures have been updated on an "as needed" basis. As commented in the State report, a 10% variance in that distribution does not make a material change in the allocation of costs and charges. To demonstrate this, it can be noted that some of the indirect expenses such as the audit are split on a 50/50 basis. The cost of customer service has been based on a 60/40 split; 60% to retail and 40% to wholesale. Engineering and Attorney expenses are split on a 50/50 basis. The phone cost is allocated 75% retail and 24% wholesale.

The District is currently conducting a 6-month verification study to insure that these splits are appropriate.

All other costs are directly charged to a particular division, be it resale or wholesale. The District has a service order system which carefully identifies all costs in the operation and maintenance of the two divisions.

At the completion of the 6-month study the results will be submitted to the Board of Directors with recommendations for any rate adjustments, if necessary.

As noted in the State report, if the percentages were inaccurate by as much as 10%, this would result in a 2.3% change in the retail division's expenses, which equate to approximately \$0.56 per month, per customer.

2.) "The District pays the members of it's Board of Directors their monthly expenses, even though Board members fail to sign the reimbursement requests and always fail to provide receipts."

In the past, some Board members have occasionally failed to sign their expense vouchers. However, this has already been corrected and all expense vouchers are now signed by the Director submitting the claim. Further, all claims are checked to insure that appropriate receipts are attached.

3.) "The District lacks documentation to prove that Board requested it's members to attend activities other than Board meetings and that the Board approved payment for attendance at these activities."

Director attendance at special conferences and meetings is discussed at Board meetings. In fact, the report notes that this is recorded in the District's minutes. It is customary for many Special Districts to handle attendance at meetings, etc. as an open discussion topic at the Board meeting, which amounts to a tacit approval of attendance. It will be found that this method of approving attendance is quite common in Special Districts.

It should be borne in mind that frequently Board members have worked together many years, and attendance at standard conferences is quite routine. Discussion at a Board meeting offers everyone the opportunity to comment on reasons for attendance, costs, attendees, etc. The District has made no attempt to hide this cost, and the discussions are recorded in the minutes and conducted openly in public.

However, in order to comply with the recommendations, the District is adopting a standing resolution which identifies those meetings that are considered part of the District's operation and Director attendance will be authorized along with the payments of their expenses.

4.) "Further, the District used public funds to pay for the attendance of spouses at some of these activities."....."The California Constitution, Article 16, Section 6, prevents a Legislator from authorizing a gift of public monies....."

It should be noted that there is in the law no clear definition of a Legislator's or an elected official's expense with regard to a gift of public funds. For example, public bodies throughout the State of California, including the Legislature, many City Councils, Boards of Supervisors, and Special Districts, occasionally provide health insurance for elected officials - in some cases, even retirement. Obviously, these benefits also flow to their spouses. (This is not the case at San Juan Suburban Water.) There has been no legal definition made that this is a gift of public funds. Likewise, there has been no law, to our knowledge, to infer that attendance at conferences is a gift of public funds.

The San Juan Board has already rescinded it's policy with regard to Director reimbursement, however, and eliminated that section providing for payment for spousal attendance at conferences. (SEE ATTACHMENT "A")

5.) "The District does not always promptly re- evaluate fee advances from developers at the completion of construction projects;"

It is the standard practice of the District to promptly evaluate all fee advances. However, over the past two years the District has been subject to a dramatic increase in workload due to outside factors. The District staff was not increased nor augmented by temporary help during this period of time and, as a result, some fee advances were not promptly reviewed. Now that the District is back on it's normal work schedule, fee advances will be promptly reviewed.

6.) "The District does not have a review system to verify that water connection fees have been correctly charged and calculated."....."for the eight applications that we reviewed, four contained mathematical errors..."

In the course of studying this matter, it came to our attention that the eight samples which are alluded to were not selected at random. In fact, only the most complex applications, which required numerous calculations regarding transmission and pump fees, were selected. Normally, the fee is a single figure simply taken from a chart. The employee responsible for this has been doing it for sixteen years and is quite experienced and conscientious in carrying out this task. However, in order to insure that the calculations are correct, they are now also reviewed by the controller's office.

7.) "The District does not have sufficient controls over it's \$2,000 emergency checking account."

As noted in the report, in light of the District's \$3 million plus overall annual budget, this \$2,000 emergency checking account is rather insignificant. However, the District has already revised control procedures and the person issuing checks will no longer reconcile the account; another person will have that responsibility.

8.) "The District also paid the airfare of \$298 for the Board member's daughter to join the Board member and his spouse."

This issue appears to have been misunderstood by the reviewers. When the District's secretary made the travel arrangements, three tickets were ordered; however, the Director reimbursed the District for the daughter's added expense. Since the funds which pay for travel are not in an interest bearing account, there was no loss of interest to the District or use of public funds during the period of time between the charge for the ticket and the reimbursement by the Director. We believe this was a unique occurrence and is not expected to occur again.

9.) "In one instance, the District did not obtain competitive bids for an Engineering contract which involved the construction of a unit of work."

Again, this is an arguable point. This contract was for construction of a unique patented product, a computerized modular filter backwash system. The District could have written a specification around this particular product and put it out to competitive bid knowing full well that only one bidder could have offered this unique, patented item. It was determined by the District at the time that this would be a sham and subject to criticism. It was felt more appropriate to hire another independent Consulting Engineer to review the proposed contract to insure that the District, in fact, was doing it's best to obtain the lowest possible cost.

It is commonly found that the cost per million gallons for construction of this type of water filtration plant ordinarily runs \$300,000 per million gallons per day of capacity, exclusive of land. In San Juan's particular filter plant, the construction costs were reduced to \$91,000 per million gallons per day of capacity, demonstrating a sizable savings to the taxpayers within the San Juan Suburban Water District. Thus, the use of a patented approach by a single bidder was in fact the approach which served the public best.

10.) "The Legislative Counsel found no exceptions to the State's Contracting Laws for unique or patented products."

It is interesting to compare this issue with that in Section 22101: "The Legislature has found that electronic data-processing equipment, goods, and services are unique, and of such importance to State programs as to warrant a separate acquisition authority therefore."

The San Juan backwash system which is alluded to in this section of the report also is a computerized system of unique design, thus paralleling this particular statute. Apparently, the Legislature found that there are unique products and services available to the State of California which have to be handled as a unique process. The District, likewise, felt that this particular situation paralleled that situation and recommended that this should be allowed. (SEE ATTACHMENT "B")

11.) "We were asked to determine what the circumstances were that led to the District's loss of approximately 28,000 acre feet of water that it had previously been entitled to receive from Folsom Reservoir."

This occurrence took place between 1962 and 1967, prior to the tenure of any of the District's employees or current Board of Directors. However, it should be noted that at that time the District was caught in a dilemma. The State appears to follow two general policies; (1) "Use it or lose it," and (2) proper use of water - the State cannot tolerate a wasteful use of water; it has to be put to beneficial use.

At that time, the District did not have a need for the water and rather than spend \$5 million and waste the water to preserve a right, it elected not to take that water and let it go to a beneficial use. This decision resulted in overall water conservation and a savings to the District of over \$5 million.

SUMMARY

In summary, the suggestions or recommendations contained within the report have been or are currently in the process of being implemented and adopted by the staff, as well as by the Board of Directors.

The District wishes again to express its appreciation to the State's staff who worked on the review. In every respect, their conduct was professional and their suggestions are greatly appreciated.

It is the District's permanent intent to run an effective and efficient water agency which provides the best level of service to its customer at the least practical cost. The District intends to make use of the report to further this end.

ATTACHMENT " A "

"The District Paid and Loaned Public Funds
to Pay for the Spouses of Board Members to
Attend Some Activities" (Page 21)

It has been common practice for Water Districts throughout the State of California and particularly the Sacramento area to pay the expenses of Directors and their wives when they attend functions at the request of the District. Although it is felt the practice was legal and justified, the Board of Directors have terminated that practice.

ATTACHMENT " B "

RESPONSE I - III

Out of hundreds of contracts the San Juan Suburban Water District has let between 1971 and 1988, the Auditors questioned two. These two related to research and development to design and build a modular filter backwash system. The question falls within the purview of Section 53060, which permits local governmental entities to contract with specially trained, experienced, and competent persons to furnish special services and advice in financial, economic, accounting, engineering, legal, or administrative matters. A contract let pursuant to Section 53060 "...removes all question of the necessity of advertising for bids for 'special services' by a person specially trained and experienced and competent to perform the special services required." (Cobb v. Pasadena City Board of Education, 134 Cal.App.2d 93,96).

The engineer invented and was the patent owner of the modular filter backwash system that the District felt was the ideal system for it's needs.

The District and it's Directors could have set the specifications so narrow that only the owner of the patent would have qualified as a bidder. However, the District felt that this would be a sham bidding procedure and instead hired an independent engineer, highly qualified in this area, to review all aspects of the procedure to insure the public interest would be protected.

Subsequent events proved the Board of Directors' decision as being responsible and fiscally sound.

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps